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IN THE

Supreme Court of the United States

OCTOBER TERM, [redacted] 1970

NO. 366

STATE BANK & TRUST COMPANY,
Petitioner,

v.

MARYLAND CASUALTY COMPANY,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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FIDELITY PRINTING COMPANY, INC., HOUSTON

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MARYLAND CASUALTY COMPANY,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

The petitioner, State Bank & Trust Company, respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Fifth Circuit entered in this proceeding on May 6, 1970.

OPINIONS BELOW

The opinion of the Court of Appeals, not yet reported, appears in the appendix hereto. The opinions rendered by the District Court for the Western District of Texas in entering judgment for petitioner and in denying a motion for new trial, which have not been published, also appear in the appendix hereto.

JURISDICTION

The judgment of the Court of Appeals for the Fifth Circuit was entered on May 6, 1970. A timely petition for rehearing was denied on June 5, 1970, and this petition for a writ of certiorari is being filed within ninety days after that date. This Court's jurisdiction is invoked under 28 U. S. C., Sec. 1254(1).

QUESTIONS PRESENTED

1. Whether the Court of Appeals erred in holding, contrary to Texas law, that the transaction in which petitioner lost $50,000.00 was not a theft, notwithstanding the undisputed proof that Melvin A. Behring, the person who planned and executed the transaction, was indicted for, pleaded guilty to, was proved guilty of, and was convicted of and sentenced for theft.

2. Whether the petitioner's loss through theft is covered by Clause B of Blanket Bond Standard Form No. 24 and is not excluded by Clause 1(d) of such bond, because the form of a loan was used by the thief as a means of obtaining the petitioner's money.

3. Whether a loss through giving value in reliance upon "counterfeited" warehouse receipts was caused to petitioner, covered by Clause E of such Standard Form Bond, where the uncancelled warehouse receipts, when pledged to petitioner, were spurious and worthless because the bales of cotton they purported to represent had already been sold and removed from the warehouse by the pledgor.

4. Whether a loss through giving value in reliance upon "stolen" warehouse receipts, covered by Clause E of such Standard Form Bond, was caused to petitioner, where the warehouse receipts, in violation of state law, were not cancelled when the cotton was removed from the warehouse.

and were thereafter fraudulently pledged to the bank, and where part of such receipts had previously been obtained from a prior pledgee by fraudulent pretext.

STATUTORY PROVISIONS INVOLVED

Texas Penal Code, Art. 1413:

"Art. 1413. *The 'taking' must be wrongful*

The taking must be wrongful, so that if the property came into the possession of the person accused of theft by lawful means, the subsequent appropriation of it is not theft, but if the taking, though originally lawful, was obtained by any false pretext; or with any intent to deprive the owner of the value thereof, and appropriate the property to the use and benefit of the person taking, and the same is so appropriated, the offense of theft is complete."

Texas Penal Code, Art. 1018:

"Article 1018. *Issuing receipt without basis*

A warehouseman, or any officer, agent, or servant of a warehouseman, who issues or aids in issuing a receipt, knowing that the goods for which such receipt is issued have not been actually received by such warehouseman, or are not under the actual control of such warehouseman at the time of issuing such receipt, shall be confined in the penitentiary not exceeding five years, or be fined not exceeding five thousand dollars, or both." (Now Texas Business and Commerce Code, sec. 35-30)

Texas Uniform Commercial Code, Sec. 7-403(3):

"(3) Unless the person claiming is one against whom the document confers no right under Sec. 7-503 (1), he must surrender for cancellation or notation of partial deliveries any outstanding negotiable document covering the goods, and the bailee must cancel the document or conspicuously note the partial delivery thereon

or be liable to any person to whom the document is duly negotiated." (Now Texas Business and Commerce Code, sec. 7.403(c))

STATEMENT OF THE CASE

Respondent, a Maryland insurance company, brought this suit against the petitioner, a Texas banking corporation, in the United States District Court for the Western District of Texas, for a declaratory judgment of non-liability under a Bankers Blanket Bond Standard Form No. 24 issued by respondent to petitioner, federal jurisdiction being based solely on diversity of citizenship. Petitioner counterclaimed for its loss.

On October 10, 1966, while the bond was in effect, one Melvin A. Behring obtained the sum of $50,000.00 from petitioner through a theft. For his acts in this transaction, Behring was indicted for theft in a court of competent jurisdiction in Texas, and thereafter, with the advice of his counsel, pleaded guilty to the theft, was proved guilty, was adjudged guilty, and was given a probated sentence for the theft, which he has been serving. (Stipulation 29, R. 64-66; Defendant's Exhibits A, B, and C, R. 123-125) No question has been raised by Behring or by either of the parties hereto, as to the validity of Behring's conviction. In its brief in the Court of Appeals, (page 16) respondent conceded:

> "Here Melvin Behring was guilty of 'theft' by false pretext within the meaning of Clause B, and Maryland does not contend otherwise."

The District Judge in this case, after referring to the undisputed proof of Melvin Behring's guilt, (App. D *infra* 33-34) found that it was "beyond cavil" that "this is a loss occasioned by a theft." (App. D *infra* 34)

Notwithstanding all of the foregoing, the Court of Appeals held, in the opinion and judgment here complained of, that Behring's acts did not constitute theft. (Appendix A *infra* 20)

Clause B of the bond (R. 91) covered losses from criminal acts, including "theft." Respondent denied liability under such coverage, on the ground that the means used by Behring to obtain the petitioner's money was through what appeared to petitioner to be a loan amply secured by warehouse receipts for bales of cotton. In fact, Behring, who was one of the owners of the warehouse, had already sold substantially all of the cotton and removed it from the warehouse. When pledged to the petitioner, the warehouse receipts had not been cancelled, as required by Texas law, and therefore appeared to be genuine, although they were in fact worthless. In paying out its money, petitioner relied solely on the value of the security which it believed it was getting.

Respondent's denial of liability under Clause B depends on exclusion clause 1(d) of the bond (R. 91) which provides that the bond does not cover:

> "(d) Any loss the result of the complete or partial non-payment of or default upon any loan made by or obtained from the Insured, whether procured in good faith or through trick, artifice, fraud or false pretenses, except when covered by Insuring Clause (A), (D) or (E)."

The District Court, for the Western District of Texas held that the petitioner's loss was covered by Clause B and was not excluded by clause 1 (d), because in fact Behring, when he obtained the bank's money, knew that the warehouse receipts were worthless and never intended to repay the money and "simply used the mechanics of the loan procedure to effect the theft." (Appendix D, *infra* 34) Having

concluded that there was liability under Clause B, the District Court did not reach the question of liability under Clause E, covering, among others, losses through having given value in reliance upon securities or other instruments which prove to have been "counterfeited" or "stolen." (R. 91)

The Court of Appeals reversed the judgment of the District Court. Primarily the Court rejected the District Court's conclusion that the petitioner's loss was through theft: (Appendix A, *infra* 24)

> "As we pointed out earlier, we are not bound by the conclusionary characterization of 'theft' based upon the borrower's subjective intent that the District Court ascribed to the transaction."

The Court of Appeals therefore held that the transaction "fell squarely within the terms of the loan exclusion clause." (Appendix A, *infra* 25)

The Court of Appeals next rejected the petitioner's argument that, if the transaction was a loan, the exclusion clause still was not applicable because it does not exclude a loan obtained through theft. Again the Court refused to accept the District Court's finding that the transaction constituted theft; (Appendix A, *infra* 26)

> "It appears plain to us that a person subjectively intending to use an objectively bona fide loan transaction as a means of getting money from a bank with no intention of repayment does not procure a loan through theft."

The Court further held that the exclusion clause should not be construed most favorably to the insured, rejecting petitioner's position that under Texas law an exclusion clause, limiting coverage granted elsewhere in an insurance policy, is strictly construed against the insurer.

In holding (1) that the transaction was not a theft and (2) that the exclusion clause should not be strictly construed against the insurer, the decision of the Court of Appeals, as we shall argue under the next section of this petition, was in conflict with Texas law as decided by Texas courts.

The Court of Appeals then disposed of petitioner's claim that its loss was covered under Clause E because it had given value in reliance upon warehouse receipts that proved to be "counterfeited." It refused to follow decisions in the Third and Ninth Circuits holding that under Clause E in a standard banker's blanket bond documents were "counterfeited" if they were spurious and purported to be something that they were not. The Court chose to follow decisions in other circuits, particularly a decision of the Second Circuit, holding that to be "counterfeited" the document had to be an imitation or attempt to simulate another document or writing which is authentic.

With regard to the petitioner's contention that there is coverage under Clause E because the warehouse receipts were "stolen," the Court summarily denied it, without discussing the legal effect of undisputed facts (1) that in direct violation of Texas statutes the warehouse receipts were retained uncancelled by Behring after the cotton they purported to represent had been removed on Behring's orders from the warehouse and that Behring thereafter fraudulently delivered the receipts to the bank when the cotton was no longer in the control of the warehouse, and (2) that part of the receipts had been fraudulently obtained by Behring from a Houston bank, to which they had previously been pledged, so that Behring could sell the cotton, retain the proceeds and not pay the Houston bank, and finally use the uncancelled receipts to get still more money from the petitioner.

The Court of Appeals' judgment reversed the District Court and rendered judgment that respondent was not liable for any of petitioner's loss. (Appendix B, *infra* 30)

REASONS FOR GRANTING THE WRIT

1. The Decision Below Conflicts with the Decision of the Highest Texas Court Having Criminal Jurisdiction as to the Proper Construction of the Texas Statute Defining Theft by False Pretext, Texas Penal Code, Art. 1413.

The Court of Appeals (Appendix A, *infra* 24, 26) twice rejected the petitioner's claim of coverage against loss through theft, holding that if "objectively" the transaction was a loan, the borrower's "subjective intent" to use that means of getting the bank's money with no intention of repayment would not make the transaction a "theft." This holding is contrary to the undisputed proof that Behring was indicted for the theft, that he pleaded guilty thereto, that he was proven guilty thereof, that he was found guilty thereof, and that the Texas court has sentenced him to, and he is now serving; a probated sentence for the theft. *And yet, the Court of Appeals has held that Behring did not commit a theft.* It is almost incredible that so manifest an error could have been committed in view of the stipulation and the direct, positive, uncontroverted and unchallenged proof of the commission and conviction of the theft. (Stipulation, paragraph 29, R. 64-66, Defendant's Exhibits A, B, and C, R. 123-125)

The holding of the Court of Appeals directly conflicts with the decision of the Texas Court of Criminal Appeals, construing Texas Penal Code, Art. 1413, that theft by false pretext is committed under essentially the same facts.

Article 1413 provides that "if the taking, though originally lawful, was obtained by any false pretext, or with

intent to deprive the owner of the value thereof, and appropriate the property to the use and benefit of the person taking, and the same is so appropriated, *the offense of theft is complete.*" (Emphasis added)

The relevant Texas decision is *Hill* v. *State*, 364 S.W. 2d 381 (Tex. Cr. 1962). In that case the defendant was indicted and convicted of felony theft. The evidence showed that he obtained $200.00 from the People's National Bank, through its vice-president, Mr. Janeway, upon executing a note for that amount, secured by a chattel mortgage previously executed upon non-existing cattle. The essential similarity between that case and the present case is shown in the following quotation from the opinion: (364 S.W. 2d at 382)

> "On February 16, 1959, appellant signed a *note* for the amount and $200 was credited to his account. Mr. Janeway testified that he relied upon and would not have made the $200 *loan* on February 16, 1959, but for appellant's representation that he owned the cattle described in the *mortgage*." (Emphasis added).

The Texas Court, in affirming the conviction, held that the "intent" to obtain the property from the owner and appropriate it to the use and benefit of the taker; and the appropriation of the property, make a case of theft under Article 1413, notwithstanding the objective facts that on its face the transaction, as shown by the quotation above, was a loan: (364 S.W. 2d at 382)

> "Art. 1413, P. C., does not provide that the false pretext be made at the time the property is obtained. In fact, a false pretext is not required, in all cases, and conviction may be had for theft of property the taking of which, though lawful, was obtained *with intent to deprive the owner of the value thereof and appropriate the property to the use and benefit of the person tak-*

ing, and the same is so appropriated." (Emphasis added)

The *Hill* case, supra, very clearly holds that the Texas statute, Penal Code Art. 1413, makes the borrower guilty of theft in a transaction which the bank believes to be a bona fide loan, if, when he gets the bank's money, the borrower has the subjective intent to deprive the bank of its money and appropriate it to his own use and never pay it back. The Court of Appeals in the present case, however, felt free to hold, in conflict with the Texas court's construction of the Texas statute, that the transaction was not "theft" and that Behring did not "procure a loan by theft."

The Court of Appeals' holding is plainly erroneous. Rules of Decision Act, 28 U.S.C. Sec. 1652; see *Aero Mayflower Transit Co.* v. *Board of Railroad Commissioners*, 332 U.S. 495, 499 (1947):

> "The rule is too well settled to permit of question that this Court not only accepts but is bound by the construction of the state statutes by the state courts."

The effect of the Court of Appeals' holding reaches beyond this case, because it involves the rights of banks and the liability of insurers under an important part of the standard form of Bankers Blanket Bonds which is used throughout the nation, as evidenced by numerous reported decisions relating to Bankers Blanket Bond Standard Form No. 24. Respondent appended to its brief in the Court of Appeals several pages from the *Digest of Bank Insurance*, which are reproduced in Appendix F to this petition. This *Digest* (Appendix F, *infra* 37-43) shows that the Bankers Blanket Bond Standard Form No. 24 Revised to June, 1951, which is involved in this case, is one of the forms prepared by the Surety Association of America and approved by the Insurance and Protective Committee of the

American Bankers Association. A decision interpreting its provisions affects not only the particular case and locality but banks and surety companies throughout the nation.

One of the principal purposes of the approved forms, including Standard Form No. 24, is "to cover risks of loss due to *criminal* acts, such as embezzlement, burglary, robbery, theft, larceny etc." (See *Digest of Bank Insurance*, Appendix F, *infra* 42). In a case brought in a Federal court because of diversity of citizenship, the court should follow the decisions of the state courts as to what constitutes the covered criminal act, including theft.

The holding of the Court of Appeals is extremely critical to a very large segment of the business community of this nation. The form of Banker's Blanket Bond involved in this case contains the coverage agreed upon by the American Bankers Association in cooperation with the insurance industry. Substantially every National and State bank in the United States has a bond containing similar, if not identical, coverage. It is critical to the banking industry, as well as to the insurance industry, to know whether this bond covers losses by theft, as that crime is defined by the applicable state law. It is important that this question be answered correctly and without delay.

2. The Decision Below Conflicts with Decisions of the Texas Supreme Court as to the Construction of Exclusion Clauses in Insurance Contracts.

It may be argued by respondent that even if the bank's money was obtained by theft still the Court of Appeals' decision can be sustained on the ground that exclusion clause 1(d) applies to *any* loss through the non-payment of *any* loan. The Court of Appeals did not base its holding on this ground, relying on its *no-theft* conclusion, but in

substance this ground has been argued by respondent. Such argument disregards the fact that exclusion clause 1(d) does not exclude any loss from non-payment of any loan and stop there. It goes on to specify the kinds of loans excluded. Loans obtained by "theft" are *not* specified. If exclusion 1(d) is construed together with Coverage B, the conclusion is at the very least reasonable that loans obtained by acts that constitute theft are not excluded. It would in large measure nullify the coverage which the bond holds out to banks under Clause B, against losses by criminal acts, if losses which result from theft by use of the loan procedure are excluded. The loss is still the result of theft if the thief, perhaps in the mistaken belief that he can thus avoid criminal liability, is able to persuade the bank to make what it believes to be a bona fide and amply secured loan. Texas cases, ignored by the Court of Appeals, hold that an exclusion clause that attempts to take back part of the coverage that is promised in another part of the insurance contract, is to be strictly construed *against* the insurer. In conflict with this settled Texas rule, the Court of Appeals broadly construed exclusion clause 1(d) *in favor of* the insurer. The Texas cases are to the contrary. *Providence Washington Insurance Company* v. *Proffitt*, 150 Tex. 207, 239 S.W. 2d 379, 381 (1951):

> "It is a settled rule in this state that policies of insurance will be interpreted and construed liberally in favor of the insured and strictly against the insurer. (Citations omitted) It is *also* well settled that *exceptions and words of limitation will be strictly construed against the insurer.* (Citations omitted) *We will certainly not write a limitation of liability into a policy where none exists.*" (Emphasis added)

Continental Casualty Co. v. *Warren*, 152 Tex. 164, 254 S.W. 2d 762, 764 (1953):

". . . and if the intended effect of the description of the risk is to limit the persons insured so as to eliminate one group of them altogether, it thus operates as an indirect sort of *exclusion or exception clause and should accordingly be very clear insofar as it is to deny application of the insurance.*" (Emphasis added)

On this point, also, the effect of the Court of Appeals' decision reaches beyond this case. In diversity cases, are the exclusion clauses, and particularly the "loan exclusion" clause in Bankers Blanket Bond Standard Form No. 24, to receive such construction as the Federal courts may adopt, notwithstanding that such construction conflicts with a rule of construction which is settled law in the highest state court? We submit that in this respect also it is important that the rule in *Erie R. Co.* v. *Tompkins*, 304 U.S. 64 (1938) be not disregarded. While the opinion of the Court of Appeals (Appendix A, *infra* 25) makes a reference to Texas law, it cites no Texas cases and disregards the Texas cases we have cited above, relating to the situation here, in which an exclusion clause must be construed in the light of a coverage clause. It reaches a conclusion plainly in conflict with the result that would be required by the application of the settled Texas rule of construction in such cases.

3. The Decision Below Conflicts with Decisions of the Third Circuit and the Ninth Circuit regarding the Construction of "Counterfeited" as Used in Coverage E of the Bankers Blanket Bond Standard Form No. 24, and Also Conflicts in Principle with the Texas Law Relevant to Such Construction.

The Court of Appeals, after denying protection to petitioner under Clause B, considered petitioner's claim of coverage under Clause E, because petitioner had given value in reliance on warehouse receipts that were "counterfeited." While the receipts were worthless when pledged

to the bank, and then purported to be something they were not, *i.e.*, title documents to bales of cotton in the warehouse, the Court of Appeals held that they were not "counterfeited." The Court of Appeals chose to follow decisions in some other circuits, particularly *Exchange National Bank of Olean* v. *Insurance Company of North America*, 341 F. 2d 673 (2d Cir. 1965), cert. den. 382 U.S. 816 (1965). It refused to follow decisions in the Ninth and Third Circuits to the contrary, *United Pacific Insurance Co.* v. *Idaho First National Bank*, 378 F. 2d 62 (9th Cir. 1967); *Fidelity Trust Co.* v. *American Surety Co. of New York*, 268 F. 2d 805 (3rd Cir. 1959). From the latter case, the Court of Appeals quoted (Appendix A, *infra* 27) three sentences from the opinion written by Judge Goodrich, which we quote more fully to show in context the reasons for his decision: (268 F. 2d at 807)

> "The bond contained in the record is a printed form submitted by the surety company. If there is doubt about the meaning of language under those circumstances, it is not to be resolved in favor of the one who chose the words and as a business transaction issued the bond to another. Its very term 'Blanket Bond' indicates that its coverage is to be wide and it is not unfair to interpret the document in this fashion."
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> * * * * *
>
> "Both sides have referred us to many dictionary definitions of 'counterfeit.' Dictionary definitions are useful, of course. But in a business transaction we think that the use of the words is to be taken in accordance with common business usage as much as possible. We think that common usage would indicate that counterfeit is something that it is not. And that is just what these spurious invoices were. They looked all right even as to details but they were not what they seemed to be."

Rejecting the reasoning of Judge Goodrich's opinion, the Court of Appeals in the present case adopted the narrow construction of "counterfeited" which restricts it to instances where a document or writing is "an imitation" or "attempts to simulate another document or writing which is authentic." (Appendix A *infra* 28)

Clearly the Fifth Circuit in the present case is in conflict with the law as decided in the Third and Ninth Circuits. The situation which now exists is that the meaning of Bankers Blanket Bond Standard Form No. 24 in respect to "counterfeited" in Clause E will vary according to the circuit in which the case is brought. It is submitted that the conclusion of Judge Goodrich, quoted above, takes proper account of law and business usage, and that the construction by the Fifth and other circuits, giving a narrow construction of the coverage, is erroneous.

We further submit that the construction of the bond as to the meaning of "counterfeited" is a question of state law. Impliedly, the Court of Appeals recognized that this is true when in its opinion (Appendix A, *infra* 27), it said that it had been cited to no "helpful" Texas authority on this question. However, instead of considering Texas cases stating the rules for the construction of bonds and other insurance contracts, the Court of Appeals referred to decisions in other Federal Circuits and chose to align itself with the "majority rule" exemplified by the opinion of the Second Circuit in *Exchange National Bank of Olean* v. *Insurance Co. of North America*, 341 F. 2d 673 (2d Cir. 1965). Had the Court given adequate consideration to the Texas decisions which were cited, it should have seen the applicability of the principle of construction stated in *Providence Washington Insurance Company* v. *Proffitt*, 150 Tex. 207, 239 S.W. 2d 379, 381 (1951):

> "It is a settled rule in this state that policies of insurance will be interpreted and construed liberally in favor of the insured and strictly against the insurer."

Surely if two Federal Circuits have construed "counterfeited" as petitioner urges that it should be construed, and one of those opinions was written by a judge of the stature of Judge Goodrich, such construction is at least reasonable and should be adopted if the bond is to be construed according to Texas law "liberally in favor of the insured and strictly against the insurer." Here again the Court of Appeals chose to disregard Texas law and adopt a construction that narrowly limited the coverage of the bond, in favor of the insurer. We submit that the importance of the proper construction of the standard form of bond in general use for insuring banks justifies the granting of a writ of certiorari.

4. The Decision Below Conflicts in Principle with Texas Decisions Regarding the Construction of "Stolen" as Used in Coverage E of the Bankers Blanket Bond Standard Form No. 24.

Coverage E of the Bond insures against losses through having given value in reliance on securities, documents or other instruments which prove to have been "stolen." (R. 91) It is the contention of the petitioner that the warehouse receipts upon which petitioner relied in paying out its money were "stolen," because (1) in failing to cancel such receipts when the cotton they represented was removed from the warehouse and in pledging them, still uncancelled, to the petitioner, Behring was acting in violation of Texas statutes requiring the cancellation of such receipts and forbidding their delivery when the cotton they purported to represent was no longer in the warehouse, and (2) 93 of such receipts had been fraudulently obtained

from a prior pledgee, the First City National Bank of Houston, and had been appropriated by Behring to his own use, without paying any of the proceeds of sales of the cotton to such pledgee.

The Court of Appeals summarily overruled petitioner's contention without discussion. It ignored the undisputed facts (Stipulation, paragraphs 1-30, R. 43-67) about Behring's handling of the warehouse receipts and the Texas statutes which plainly required the cancellation of the warehouse receipts when the cotton was removed from the warehouse and prohibited the issuance of such receipts by Behring (a partner in the firm owning the warehouse) when there were no such bales of cotton in the control of the warehouse. Texas Uniform Commercial Code, Sec. 7-403 (3); Texas Penal Code, Art. 1018 (both quoted supra 3). It also ignored the undisputed facts (Stipulation, paragraphs 31-72, R. 67-90) regarding 93 of the warehouse receipts, which were in summary that Behring has used these receipts as a means of getting financing from the Houston bank, that he then secured their surrender by the Houston bank upon agreements that the proceeds of sales would be applied to the debt owing the Houston bank, that Behring sold the cotton and was paid for it but did not pay any of the proceeds to the Houston bank, and finally that Behring pledged the uncancelled receipts to the petitioner, which had no knowledge of the previous pledge to the Houston bank.

Texas cases hold that bonds insuring against losses through criminal acts do not make it "a prerequisite to a recovery that the offending party should be technically and criminally guilty of the offenses named in the bond." See *Fidelity & Deposit Company* v. *Central State Bank of Dallas*, 12 S.W. 2d 611, 612 (Tex. Civ. App., 1928) Behring's unlawful acts in dealing with the warehouse receipts, so

as to defraud the petitioner, should under the liberal construction of such bonds required by Texas decisions, be held to bring such receipts within the meaning of "stolen" as used in Coverage E. As to the 93 warehouse receipts fraudulently obtained from the Houston bank, we submit there can be no doubt that they were "stolen" by Behring within the meaning of Texas Penal Code, Article 1413, defining theft by fraudulent pretext, which we have already discussed, *supra* 8-10. The Court of Appeals, as we respectfully submit, was not justified in summarily disposing of petitioner's position, which is supported by applicable Texas law.

CONCLUSION

For the reasons we have stated, we respectfully submit that a writ of certiorari should issue to review the judgment and opinion of the Court of Appeals for the Fifth Circuit in this case.

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CERTIFICATE OF SERVICE

I hereby certify that on this ..... day of ....., 1970, three copies of the foregoing Petition for Writ of Certiorari were mailed, first class, postage prepaid, to Will G. Barber, 900 Brown Building, Austin, Texas 78701, counsel for Respondent. I further certify that all parties required to be served have been served.

.....

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APPENDIX A

IN THE
UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 28464

MARYLAND CASUALTY COMPANY,
Plaintiff-Appellant,

versus

STATE BANK & TRUST COMPANY,
Defendant-Appellee.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF TEXAS

(May 6, 1970)

Before THORNBERRY, DYER and CLARK
Circuit Judges

DYER, Circuit Judge: In this appeal we are called upon to decide, on undisputed evidence, whether a loss suffered by State Bank was covered by its standard form banker's blanket bond issued by Maryland. The District Court found that the bond insured against the loss and entered judgment for State Bank. We disagree and reverse.

The facts are uncomplicated. Behring and Behring, a partnership composed of Arthur H. Behring and Melvin A. Behring, owned and operated San Marcos Compress, a licensed and bonded warehouse, located in San Marcos, Texas. As bales of cotton were received at the warehouse

for storage, warehouse receipts, in bearer form, were issued by the Compress. When bales of cotton were removed from the warehouse, Texas law required the surrender of the receipts to and their cancellation by the Compress.

Contrary to law, Melvin Behring apparently ordered the employees at the Compress not to cancel the warehouse receipts held by the partnership when the bales of cotton that they represented were sold and shipped out of the Compress. A large number of receipts, including the seven hundred receipts here involved, were purchased by the Behring partnership.

Melvin Behring negotiated a loan with State Bank. He told the president that the partnership would give the Bank seven hundred bales of cotton as security. Before the loan by State Bank to the partnership was made, six hundred and ninety-six of the seven hundred bales of cotton were sold for $69,914.64 without cancellation of the warehouse receipts here in suit. Ultimately the Bank loaned $50,000.00 to the partnership. The debt was evidenced by a partnership promissory note in that amount which was secured by a security agreement — pledge of the partnership under which it pledged seven hundred bales of cotton represented by negotiable warehouse receipts in bearer form issued by the Compress.

In making the loan the Bank did not rely upon the financial statements furnished by the partnership but relied solely upon the security of the warehouse receipts, believing that the partnership owned seven hundred bales of cotton purportedly covered by the warehouse receipts which cotton should have been in the Compress. The Bank would not have issued its check to the partnership if it had known that in fact the cotton was not in the Compress as represented.

When the Bank received information that substantially all of the cotton represented by the warehouse receipts held by it had been sold to others and had been shipped out of the warehouse, it made demand on the partnership for payment of the note. The partnership defaulted and it was subsequently adjudicated a bankrupt.

Melvin Behring was charged with theft of the $50,000 from the Bank's president. He pleaded guilty to theft by false pretenses and was adjudged guilty of that offense by the District Court of Hays County, Texas.

Maryland brought this action seeking a declaratory judgment that there was no liability under its bond for the Bank's loss. The Bank answered and counterclaimed seeking recovery of its $50,000 loss.

The Bank relies upon Clause B of the bond which provides, in pertinent part, that Maryland agrees to indemnify the Bank against:

> Any loss of property through robbery, burglary, common-law or statutory larceny, theft, false pretenses, hold-up, misplacement, mysterious unexplainable disappearance . . . .

Maryland, on the other hand, relies upon a loan exclusion clause in the bond which excludes from coverage:

> (d) Any loss the result of the complete or partial non-payment of or default upon any loan made by or obtained from the Insured, whether procured in good faith or through trick, artifice, fraud or false pretenses, except when covered by Insuring Clause (A), (1) or (E).

The crux of this appeal is the correct interpretation of these clauses and Insuring Clause (E) which we discuss *infra*.

The District Court concluded that "the transaction cannot be called a loan within the language of the exclusion clause" because "Behring knew . . . not only that the warehouse receipts were valueless but also that he never intended to repay the money. He wanted to steal the money, not to obtain a loan, and he simply used the mechanics of the loan procedure to effect the theft. With Behring having such an intent, the transaction cannot be called a loan within the language of the exclusion clause. There being no loan, there is no exclusion." The Court then held that since the loss was the result of theft it was covered under Clause B of the bond.

For the reasons that we will delineate, we are convinced that the District Court's interpretation of the loan exclusion clause is erroneous. No authority to support its conclusion that the clause was inapplicable was mentioned in the trial judge's memorandum opinion. Bank's counsel has been unable to authoritatively support the judgment. And we have, after considerable search, turned up nothing that has the slightest persuasiveness that the exclusionary clause of the bond can be nullified by the subjective fraudulent intent of the borrower, notwithstanding that the objective indicia all point one way — that a loan was made by the Bank to the partnership.

> The district court's finding on this ultimate issue, * * * is not to be garrisoned by the clearly erroneous rule. Though it has factual underpinnings this ultimate issue is inherently a question of law. Obeisance to the clearly erroneous rule must yield when the facts are undisputed and we are called upon to reason and interpret. This is the law obligation of the court as distinguished from its fact finding duties. *United States* v. *Winthrop*, 5 Cir. 1969, 417 F.2d 905, 910.

In *Community Federal Savings & Loan Association* v. *General Casualty Co.*, 8 Cir. 1969, 274 F.2d 620, which we recently cited with approval in *East Gadsden Bank* v. *United States Fidelity and Guaranty Co.*, 5 Cir. 1969, 415 F.2d 357, the borrower furnished the lender with false affidavits to the effect that buildings had been completed on various lots that were taken as security for a loan made by the lender. Upon subsequent default by the borrower, the lender sued on its bond which excluded "any loss the result of the complete or partial non payment of or default upon any loan made by or obtained from the Insured, whether procured in good faith or through trick, artifice, fraud or dishonesty * * *". In finding that the loan exclusionary clause applied, the court said:

> Plaintiff insists that its loss is not the result of a complete or partial nonpayment of or default in any loan made or obtained by it. Plaintiff argues that if the statements as to the completion of the buildings and the payment of lien claims had been true, no loss would have been suffered; hence, the fraud was the cause of the loss. The same type of claim could doubtless be made in almost any type of loan induced by fraud. It is undisputed that loans were made which remain unpaid in part. While the loan was induced by fraud, it seems clear that the immediate cause of the loss was the nonpayment of the loans. It is entirely clear from the exclusion provision as written that the exclusion extends to losses on loans induced by fraud.

Id. at 624, 625.

We are unpersuaded by State Bank's argument that *Community Federal* can be distinguished because fraud was there involved, while here there was a theft. As we pointed out earlier, we are not bound by the conclusionary characterization of "theft" based upon the borrower's subjective intent that the District Court ascribed to the transaction.

We perceive no basic difference in the case *sub judice* and *Community Federal*. In this case the promissory note was accepted by the Bank as the legal liability of the partnership. Upon that evidence of indebtedness, secured by the warehouse receipts, the Bank made its loan. It is uncontradicted "that the basic transaction was a loan," that it remained unpaid, and that the default was the "immediate cause" of the loss. *East Gadsden, supra*, at 360. The transaction thus fell squarely within the terms of the loan exclusion clause. *See, First National Bank of Memphis* v. *Aetna Casualty & Surety Co.*, 6 Cir. 1962, 309 F.2d 702, *cert. denied* 83 S.Ct. 951 (1963).

The Bank next presses its argument that the clause in question is ambiguous and should be construed against the insurer because "a distinction is intended between a loan procured through a crime, such as theft, and a loan which, though wrongfully procured, was obtained under such circumstances as to create only a civil liability and not a criminal liability." We are unable to accept this periphrastic proposition. The District Court did not rest its decision on the premise here urged by the Bank. It found that there was no loan but that "the mechanics of the loan procedure" were used "to effect a theft." The distinction of criminal vis-a-vis civil liability sought to be drawn by the Bank as the benchmark of coverage vel non has support in neither the language of the loan exclusion clause nor in precedent.

In Texas whether an ambiguity exists in the language of an exclusionary clause is one of law. If the language "is clear and unambiguous, such meaning must be given to the language as will carry out and effectuate the intention of the parties. In that even, rules of construction, such as adopting that construction most favorable to the insured, are not to be applied." *St. Paul Mercury Insurance Company* v. *Price*, 5 Cir. 1966, 359 F.2d 74, 76. We find the language here under consideration to be "clear and unambig-

nous." *East Gadsden, supra; Community Federal, supra; Depositors Trust Co. v. Maryland Casualty Co.*, Me. 1961, 174 A.2d 288. It appears plain to us that a person subjectively intending to use an objectively bona fide loan transaction as a mean of getting money from a bank with no intention of repayment does not procure a loan through theft.

State Bank next argues that if its loss is not recoverable under Clause (B) because it is within the provisions of the loan exclusion clause, it nevertheless is entitled to recover $40,000, the limit of liability under Clause (E).

The District Court had no occasion to reach the question of coverage under Clause (E) and consequently did not do so. The case was submitted to the District Court on stipulated facts, and since the parties have fully briefed and argued the Clause (E) coverage question, "we can see no useful purpose that could be served in remanding for further consideration." *L. W. Brooks, Jr. v. Commissioner of Internal Revenue*, 5 Cir. 1970, ... F.2d....., [No. 27,517, April 8, 1970]. *Dandridge v. Williams*, 1970, ...U.S. ....., No. 131, October Term, 1969 (April 6, 1970); *Langnes v. Green*, 1931, 282 U.S. 531. "[T]he appellee may, without taking a cross-appeal, urge in support of a decree any matter appearing in the record, although his argument may involve an attack upon the reasoning of the lower court or an insistence upon matter overlooked or ignored by it." *United States v. American Ry. Exp. Co.*, 1924, 265 U.S. 425, 435.

Accordingly, we proceed to a consideration of that clause. It provides:

> (E) 'Any loss through the Insured's having, in good faith and in the course of business, whether for its own account or for the account of others, in any representative, fiduciary, agency or any other capacity, either

> gratuitously or otherwise; purchased or otherwise acquired, accepted or received, or sold or delivered or given any value extended any credit or assumed any liability on the faith of or otherwise acted upon any securities documents or other written instruments which prove to have been counterfeited or forged as to the signature of any maker, drawer, issuer, endorser, assignor, lessee, transfer agent or registrar, acceptor, surety or guarantor or as to the signature of any person signing in any other capacity, or raised or otherwise altered or lost or stolen * * *.

State Bank concedes that the warehouse receipts were not *forged* but it insists that they were *counterfeited* or *stolen* securities within the meaning and intent of Clause (E). It is uncontroverted that all of the warehouse receipts were genuine, bona fide, valid and valuable at the time each of them was originally issued and that they were worthless at the time they were pledged by the partnership to the Bank.

We have no citation of any Texas authority which is helpful on the question of what may be considered counterfeit within the meaning of Clause (E). State Bank relies on *United Pacific Insurance Company* v. *Idaho First National Bank*, 9 Cir. 1967, 378 F.2d 62 which adopted the reasoning of *Fidelity Trust Company* v. *American Surety Company of New York*, 3 Cir. 1959, 268 F.2d 805. In *Fidelity* the court held Clause (E) applicable because "Common usage would indicate that counterfeit is something that purports to be something that it is not. And that is just what these spurious invoices were. They looked all right even as to details but they were not what they seemed to be." *Id.* at 807.

The majority of courts faced with this problem have held, however, upon various theories, that invoices and accounts receivable similar to the warehouse receipts here

involved, cannot be considered "counterfeit" within the meaning of Insuring Clause (E). *See generally, Capitol Bank of Chicago* v. *Fidelity and Casualty Co. of N. Y.*, 7 Cir. 1969, 414 F.2d 986; *First Nat. B & T Co. of Oklahoma City* v. *United States F. G. Co.*, 10 Cir. 1965, 347 F.2d 945; *Exchange Nat. Bank of Olean* v. *Insurance Co. of No. Amer.*, 2 Cir. 1965, 344 F.2d. 673, *cert. denied* 382 U.S. 816, 86 S.Ct. 37; *North Carolina National Bank* v. *United States Casualty Co.*, 4 Cir. 1963, 317 F.2d 304, *cert. denied*, 375 U.S. 905, 84 S.Ct. 193, 11 L.Ed.2d 144; *First Nat. Bank of Memphis* v. *Aetna Casualty & Surety Co.*, 6 Cir. 1962, 309 F.2d 702, *cert. denied* 372 U.S. 953, 83 S.Ct. 951, 9 L.Ed.2d 977; *First National Bank of South Carolina* v. *Glens Falls Ins. Co.*, 4 Cir. 1962, 304 F.2d. 866.[1]

We align ourselves with the majority rule and adopt the reasoning of the Second Circuit in *Exchange Nat. Bank, supra:*

> A document or writing is counterfeit if it is an imitation, if it attempts to simulate another document or writing which is authentic. The deceptive and fraudulent quality of these invoices, however, arose, not from the effort to imitate or simulate authentic invoices, but from falsity of the implicit and explicit representations of fact, to wit, that certain goods had already been shipped to a customer. To hold that these invoices are counterfeit would obliterate elementary distinctions among the techniques of deception. These distinctions are recognized in ordinary and commercial

[1] State cases following the majority view include: *State Bank of Kenmore* v. *Hanover Insurance Company*, 165, 267 N.Y.S. 2d 672; *aff'd*, 269 N.Y.S. 2d 388; *Union Banking Co.* v. *United States Fidelity & Guaranty Co.*, Ohio App. 1965, 213 N.E.2d 191; *First Am. State Bank* v. *Aetna Cas. & Sur. Co.*, Wis. 1964, 130 N.W.2d 824; *United States Fid. & Guar. Co.* v. *First Nat'l Bank of Ft. Morgan*, Cal. 1961, 364 P.2d 202.

> usage and they are preserved in the bond. Not all defaulting loans obtained upon the basis of fraud and deception are covered. In fact, the bond generally excludes from coverage losses resulting from default on loans, regardless of whether the loan was procured through trick, artifice, fraud or false pretenses; the limitation on this exclusion for loans fraudulently obtained through the use of counterfeit documents merely appears as an exception to the general exclusion. There is a difference between extending credit on the basis of pledged counterfeit stock certificates, a risk clearly within the purview of the bond, and extending credit on the basis of invoices that cover non-existent shipments and that have been submitted as evidence of previously pledged accounts receivable. The bank could verify the existence of the pledged accounts receivable by inquiring with the loan applicant's purported customer, while detecting a counterfeit security is likely to pose significantly different and more serious risks to the bank.

Id. at 676.

We summarily dispose of State Bank's contention that there is coverage under Clause (E) because the warehouse receipts were "stolen" when they were delivered to the bank. Bank concedes that this contention lacks the underpinning of any authority. We think this is frivolous.

Concluding, as we do, that the loan exclusion clause is applicable and that Insuring Clause (E) is inapplicable, we reverse and render judgment for Maryland Casualty Company.

REVERSED and RENDERED.

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

October Term, 1969

No. 28464

D. C. Docket No. CA 67-26-A

MARYLAND CASUALTY COMPANY,
Plaintiff-Appellant,

v.

STATE BANK & TRUST COMPANY,
Defendant-Appellee.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF TEXAS

Before THORNBERRY, DYER and CLARK,
Circuit Judges.

JUDGMENT

This cause came on to be heard on the transcript of the record from the United States District Court for the Western District of Texas, and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be, and the same is hereby, reversed and rendered for Maryland Casualty Company, in accordance with the opinion of this Court.

It is further ordered that defendant-appellee pay to plaintiff-appellant, the costs on appeal to be taxed by the Clerk of this Court.

May 6, 1970

Issued as Mandate:

APPENDIX C

IN THE
UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 28464

MARYLAND CASUALTY COMPANY,
Plaintiff-Appellant,

v.

STATE BANK & TRUST COMPANY,
Defendant-Appellee.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE
WESTERN DISTRICT OF TEXAS

(June 5, 1970)

ON PETITION FOR REHEARING

Before THORNBERRY, DYER and CLARK, Circuit Judges.

PER CURIAM:

IT IS ORDERED that the petition for rehearing filed in the above entitled and numbered cause be and the same is hereby denied.

APPENDIX D

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF TEXAS
AUSTIN DIVISION

CIVIL ACTION NO. 67-26-A

MARYLAND CASUALTY COMPANY,

v.

STATE BANK & TRUST COMPANY,

MEMORANDUM OPINION

This is a declaratory judgment action brought by Maryland Casualty Company (the Insurer) against the San Marcos State Bank and Trust Company (the Bank) to settle the parties' rights under a Banker's Blanket Bond issued to the Bank by the Insurer. The case was submitted to this Court on stipulated facts and oral argument.

A few days before October 10, 1966, Melvin Behring went to the Bank to negotiate a Fifty Thousand Dollar ($50,000) "loan" for Behring & Behring, a partnership of Melvin and Arthur Behring that owned and operated a warehouse in San Marcos, Texas. Behring told the President of the Bank that the partnership would give as security for the note, negotiable warehouse receipts allegedly covering seven hundred (700) bales of cotton then stored in his warehouse. Relying solely on this pledge of collateral, the loan was approved. On October 10, 1966, Arthur Behring, at the direction of Melvin Behring, delivered to the Bank the promised warehouse receipts and received the Fifty Thousand Dollars ($50,000).

The warehouse receipts given as collateral appeared on their face to be valid negotiable instruments and more than adequate security for the Fifty Thousand Dollar ($50,000)

note. However, the appearance was deceiving. The bales of cotton represented by the receipts had been shipped from the warehouse prior to the October transaction, and contrary to the Texas Business and Commercial Code, Section 7,403(c), the receipts had not been cancelled. Melvin Behring knew they should have been cancelled, but he directed the partnership employees not to do so. Of course, upon the shipping of the cotton, the receipts became valueless.

The Bank discovered Melvin Behring's duplicity on October 31, 1966, and demanded payment of the Fifty Thousand Dollars ($50,000). The demand was not met. On September 11, 1967, the Hays County Grand Jury charged in Court 4 of an indictment that:

> Melvin A. Behring, on or about the 10th of October, A.D. 1966 . . . in the County of Hays, State of Texas, did then and there unlawfully and fraudulently take $50,000 in cash money of the value of FIFTY THOUSAND and no/100 DOLLARS, the same then and there being the corporeal personal property of and belonging to J. R. Thornton (president of the Bank), from the possession of the said J. R. Thornton without the consent of the said J. R. Thornton and with the intent to deprive the said J. R. Thornton of the value thereof, and with the intent to appropriate it to the use and benefit of him the said MELVIN A. BEHRING, and did so appropriate it. . . .

On November 20, 1968, Behring waived his right to trial by jury and plead guilty to this count in the indictment charging felony theft.

On these facts the Bank contends that the fifty thousand dollar ($50,000.) loss is covered by paragraph (B) of the Bond, which provides that the Bank is insured against "(a) any loss of property through robbery, burglary, common law or statutory larceny, theft, false pretenses, hold-

up, misplacement, mysterious unexplainable disappearance, damage thereto or destruction thereof, whether effected with or without violence or with or without negligence on the part of any of the Employees. . . ."

The Insurer does not contest coverage; rather, it relies on Section 1(d) of the exclusion clause which states that the Bond does not cover "(a)ny loss the result of the complete or partial nonpayment of or default upon any loan made by or obtained from the insured, whether procured on good faith or through trick, artifice, fraud or false pretenses except when covered by Insuring Clause (A), (D), or (E)."

Before reaching the extremely difficult legal questions involved in the interpretation of the Bond, the factual and legal framework should be made clear. (1) Behring plead guilty to the felony charge, so it must be assumed that he was guilty, that he intended on the day of the loan to permanently appropriate the Fifty Thousand Dollars ($50,000) to his own use with no plans to ever pay the Bank. (2) It goes without citation that the Bond should be construed strictly against the Insurer, especially provisions limiting liabiltiy.

That coverage exists under (B) is beyond cavil: This is a loss occasioned by a theft. The critical question is whether the exclusion clause takes that coverage away. The Court thinks not. The *sine qua non* of the exclusion is the existence of a loan. Behring knew at the time he made the October 10, 1966, transaction not only that the warehouse receipts were valueless but also that he never intended to repay the money. He wanted to steal the money, not to obtain a loan, and he simply used the mechanics of the loan procedure to effect the theft. With Behring having such an intent, the transaction cannot be called a loan within

the language of the exclusion clause. There being no loan, there is no exclusion.

The Court therefore declares the Insurer liable for the Bank's actual loss caused by Behring's theft and does not reach the question of Clause E coverage.

Signed at Austin, Texas, this 8th day of July, 1969.

/s/ Jack Roberts
JACK ROBERTS
United States District Judge

APPENDIX E

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF TEXAS
AUSTIN DIVISION

Civil Action No. 67-26-A

MARYLAND CASUALTY COMPANY
v.
STATE BANK & TRUST COMPANY

ORDER DENYING MOTION FOR NEW TRIAL AND TO ALTER OR AMEND JUDGMENT

Came on this day for consideration by this Court, a motion by Plaintiff, MARYLAND CASUALTY COMPANY, for new trial and to alter or amend judgment; and after a careful reading of the motion, brief and reply filed by Defendant, STATE BANK & TRUST COMPANY, this Court is of the Opinion that the motion is without merit and denied because Plaintiff assumes the "fact" that has to be established and sweeps the heart of the case under the rug and forgets it — namely this is a "theft" and was never a "loan" at any time. Being clearly erroneous and based on misconception, the motion for new trial and to alter or amend judgment is overruled.

It is further ORDERED that the Clerk of this Court furnish copies of this Order to all attorneys of record.

Signed at Austin, Texas, this 1st day of August, 1969.

/s/ JACK ROBERTS
Jack Roberts
United States District Judge

APPENDIX F

DIGEST OF BANK INSURANCE

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BANKERS BLANKET BONDS

Before Bankers Blanket Bonds came into use, even the larger banks found it necessary to use several different forms of insurance contracts to protect against the many risks to which they were exposed. Prior to 1915, for example, to obtain suitable insurance protection, a bank might well have considered it necessary to carry the following set of contracts:

Fidelity Bonds
Bank Burglary and Robbery Policy
Messenger Robbery Policy
Forgery and Alteration Policy
Forged Securities Bonds or Policy
Safe Deposit Burglary and Robbery Policy

The banker not only had to familiarize himself with many different forms, but even with all these contracts in his insurance portfolio, he may not have felt fully confident that his bank was getting the protection it needed. For instance, were there any gaps in the coverage between the contracts? Was there any overlapping of risk protection, making the cost more than need be? Today a banker can buy one contract to take the place of the first five of the six bonds and policies referred to.

In the years 1915 and 1916 there was a growing demand among banks for this more comprehensive protection in a form that would cover not only the fidelity of a bank's officers and employees, but also forgery risks and the hazards of holdup, burglary, robbery, etc., pertaining to money and securities of the bank on its *premises*, as well as similar risks while in *transit*. In the early blanket bonds the then Insurance Committee of the American Bankers Association made certain that the broader forms covered

"misplacement" because in the regular conduct of business, losses of money, securities and other property occurred which could not be attributed to any specific act, omission or person. Such losses were recoverable as being due to "misplacement." And in 1936, to avoid disclaimer of liability by a surety drawing a distinction between the act of definite *misplacement* as distinguished from a *mysterious disappearance*, the coverage was specifically broadened to indemnify against "mysterious unexplainable disappearance."

Separate Contracts Limited Protection: Under separate contracts it was not possible to get all the protection banks deemed desirable, because coverage was limited by the declaration requirements to insure specific amounts on each safe as to burglary risks. Determination of specific amounts on each individual employee in respect to fidelity risks was also unsatisfactory. A decided advantage of a blanket contract is that each and every employee and other risks are covered for the total amount of the bond. Moreover, new employees and new branch offices are automatically covered. No notice need be given to the underwriters of blanket bonds and no additional premium need be paid for an increase in the number of employees or checking accounts or for branch offices established during a premium period unless the increase results from a merger or combination with another bank. The work "blanket," however, refers to the blanket *amount* which applies to the several risks covered under the bond and is not intended to mean "all risk" coverage.

Prior to 1915 more inclusive policies in blanket form were available from Lloyd's of London and this tended to stimulate the demand among the banks for a single contract covering several risks in a blanket amount. The efforts of the American Bankers Association during 1915 and 1916

brought a better realization to the American companies of the buyer's needs, to the end that domestic surety companies offered new forms of a blanket nature.

First A.B.A. Approved Form: Bankers blanket bond forms were drafted by the American companies in 1915 and 1916, but it was not until June 8, 1916, that their form was sufficiently satisfactory to warrant approval by the then Insurance Committee of the American Bankers Association. To keep abreast of changing conditions and loss exposures in banking, both domestic and Lloyd's forms have been improved periodically over the past forty years. These improvements were effected through joint conferences between committees representing the American Bankers Association and the Surety Association of America or Underwriters at London Lloyd's.

In March 1941, the surety companies offered a more comprehensive form of blanket bond to accommodate the needs of those larger banks whose operations and exposures demanded broader blanket coverage in large amounts. This bond designated Standard Form No. 24 was made available to *all* commercial banks and trust companies in September 1941. It was revised in March 1946 and again in June 1951 to incorporate a number of improvements, some of which had been effected by riders to existing bonds during the previous five-year periods. Additional improvements have been effected by riders to the June 1951 form.

Acquiring a broad comprehensive form of coverage should not lead to any relaxation in loss preventive measures. One need read only the list of exclusions (Section 1 of the domestic bonds) to realize that there are and must be some limitations to the risks covered. From the standpoint of sound banking and underwriting alike, it is admittedly undesirable to cover losses which result from bad

credit risks, clerical errors, carelessness, incompetence, etc. Also, forgery risks should be optional both as to their inclusion and the amount which may be less than the blanket amount of the bond.

Carrying along this thought about a broad, comprehensive bond, let us examine the forms currently used, analyze their coverages and limitations, and also see how they compare with one another.

DESCRIPTIONS OF FORMS

There are three forms in which we are primarily interested for commercial banks and trust companies and two additional forms for savings banks. Broadly speaking, it is intended that the scope of these forms is to cover risks of loss due to *criminal* acts, such as embezzlement, burglary, robbery, theft, larceny, forgery, etc. However, these forms provide indemnity for loss of property through damage, destruction, misplacement and mysterious unexplainable disappearance.

The two commercial bank forms now approved by the Insurance and Protective Committee of the American Bankers Association are:

Bankers Blanket Bond Standard Form No. 24
Revised to June, 1951

Lloyd's Banks' and Trust Companies' Policy
Form HANC (1955)

The other form for commercial banks is:

Bankers Blanket Bond Standard Form No. 2
Revised to June, 1951

For the purpose of brevity and easy reading, these forms are referred to as Forms 2, 24, and HANC — or HAN(C) on pages not revised since 1955.

Losses resulting from misplacement or mysterious disappearance of money or securities have occurred in banks with sufficient frequency to make these risks appear to be inherent with everyday banking operations. Accordingly, in February 1949, the A.B.A. Insurance and Protective Committee recommended to the Surety Association of America that coverage against these risks be made a component part of Premises Insuring Clause B and Transit Insuring Clause C of Forms 2 and 24.

The Committee's proposal was adopted on January 9, 1950, when the 20 per cent loading theretofore added for misplacement coverage in Forms 2 and 24 was discontinued by conference companies.* Banks which prefer carrying misplacement coverage for less than the total amount of their blanket bond(s) are allowed a 5 per cent credit on the premium charged for that portion of the bond(s) over $25,000 from which misplacement is eliminated.

When banks desire to carry Form 24 without the exclusion of tellers' shortages *due to errors*, the premium for the first $25,000 of coverage (exclusive of the charges for forgery Clauses D and E and for branch offices) is increased by about 31 per cent. Tellers' shortages are discussed further on p. 13-b.

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* With respect to fidelity, forgery and surety bonds, the so-called conference companies are those which subscribe to the rates promulgated by the Surety Association of America, and as to casualty and liability policies, to the rates promulgated by the National Bureau of Casualty Underwriters. The forms of bonds and policies issued by conference companies are those standardized by the Surety Association of America and the National Bureau of Casualty Underwriters, but similar forms are written by some non-conference companies.